

ST 00-24

Tax Type: Sales Tax

Issue: Unreported/Underreported Receipts (Non-Fraudulent)

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**EAT-IN, Inc. d/b/a Thai Restaurant,
Taxpayer**

**No.
NTL:
IBT #
Charles E. McClellan
Administrative Law Judge**

RECOMMENDATION FOR DECISION

Shepard Smith for the Department of Revenue; Warren H. Appel for the taxpayer.

Synopsis:

This matter involves a timely filed protest to a Notice of Tax Liability for Retailers' Occupation Tax ("sales tax") issued to Thai Restaurant by the Department of Revenue on June 29, 1999. A pre-trial order was entered on July 10, 2000, in which the parties stated the issues to be decided in the following terms:

1. Whether taxpayer underreported its receipts for the period January 1, 1995 through March 31, 1998, and is liable for Retailers' Occupation Tax in the amount of \$31,198.
2. Whether taxpayer is liable for a negligence penalty.

An evidentiary hearing was held on August 8, 2000, at which both parties were represented by counsel. The parties declined to file post-hearing briefs. I recommend that the Notice of Tax Liability be made final.

Findings of Fact:

1. EAT-IN, Inc. (“taxpayer”) is a corporation that purchased the business known as Thai Restaurant in 1995. Tr. p. 8.
2. JANE DOE (“DOE”) is an employee of the restaurant as is her mother who functions as the cook. Tr. p. 10.
3. DOE, who is now 31 years old, finished high school and two years of college, but had no formal training in accounting. Tr. pp. 9, 28.
4. DOE never talked to the accountants about the kind of books and records that should be kept for the business. Tr. pp. 28, 29.
5. The firm of COUNT & COUNT did the bookkeeping for the Thai Restaurant. Tr. p. 15.
6. Taxpayer did not keep a daily logbook of sales. *Id.*
7. Every day DOE added up the customers’ receipts and put the receipts in a bucket. Tr. pp. 17, 21.
8. Taxpayer had a cash register but it did not record sales on its tape because nobody at the business knew how to operate the taping function. *Id.*
9. DOE paid bills with the money collected, took the remaining receipts home and kept them in a cookie jar until she deposited them and the credit card receipts in a bank on a weekly basis. Tr. pp. 18, 30, 31.

10. At the end of the month, DOE gave the sales numbers to COUNT & COUNT to use in preparing the sales tax returns. Tr. pp. 16, 19.
11. DOE never matched the receipts against the bank statements. Tr. pp. 18, 23.
12. DOE did not maintain a purchase journal; she just kept the receipts of purchases. Tr. p. 20.
13. The Department commenced an audit of taxpayer's Retailers' Occupation Tax Returns in July 1997 covering the period of January 1995 through March 1998. Tr. p. 43.
14. At the commencement of the audit, the Department's auditor ("auditor") requested taxpayer's records and was provided with guest checks for 1996, purchase invoices for 1996, utility bills for 1996, cash pay-outs for 1995 and 1996, and bank statements for a business account for 1995 and 1996. Tr. p. 45; Dept. Group Ex. No. 2 p. 1.¹
15. The taxpayer did not provide the auditor with a sales journal, general ledger, cash register tapes, credit card sales summary sheets, disbursement or purchase journals or any records for the other months in the audit period. Tr. p. 46.
16. The bank deposits reflected on the bank statements were more than the gross receipts reported by the taxpayer. Dept. Group Ex. No. 2 at p. 2.

¹ Dept. Group Ex. No. 2 is a 57-page exhibit consisting of the auditor's narrative report and schedules prepared by her in determining the deficiency. I will refer to it by page number (p. "n".) with "n" being the page number.

17. By reconciling the sources of bank deposits shown on the taxpayer's bank statements for each month of 1996, and reconciling the credit card sales reported therein with the credit card tickets the taxpayer provided, the auditor was able to determine the underreported cash and credit card sales for 1996. Tr. pp. 47–51; Dept. Group Ex. No. 2 at pp. 21–56.
18. In making her calculations of underreported sales, the auditor took into account a presumed gratuity of 15%. Tr. p. 50; Group Ex. No. 2 at pp. 21–56.
19. By reconciling this data, the auditor calculated that credit card sales were underreported by 53.35% per month for 1996. Tr. p. 49; Group Ex. No. 2 at pp. 21–56.
20. The auditor could not calculate the percentage of underreported cash sales in the same way as she did for the credit card sales because of the absence of records, so she applied the credit card underreporting percentage to determine the underreported cash sales 1996. Tr. pp. 50, 51; Group Ex. No. 2 at pp. 21–56.
21. The auditor applied the percentage of underreporting for 1996 to the other periods in the audit because the taxpayer did not provide books and records for those periods. Tr. pp. 51, 53–59; Group Ex. No. 2 at p. 8.
22. At the conclusion of the audit, the auditor prepared the Department's Form SC-10-K entitled "Audit Correction and/or Determination of Tax Due". Tr. p. 43; Dept. Group Ex. No. 1.

23. The Department issued a Notice of Tax Liability on June 29, 1999, assessing the amount of deficiency reflected on the Department's Form SC-10-K.

Conclusions of Law:

The Underreported Receipts Issue

The first issue to be decided in this case is whether taxpayer underreported its receipts for the audit period. The admission into evidence of the correction of return of the Department under the certification of the Director at a hearing before the Department or any legal proceeding establishes the Department's *prima facie* case. 35 ILCS 120/8; Central Furniture Mart v. Johnson, 157 Ill.App. 3d 907 (1st Dist. 1987); Copilevitz v. Department of Revenue, 41 Ill.2d 154, 242 N.E.2d 205 (1968). Thus, when the Department introduced the corrected return (Dept. Group Ex. No. 1) it established its *prima facie*.

To overcome the Department's *prima facie* case, the taxpayer must present consistent, probable evidence identified with her books and records. Copilevitz v. Department of Revenue, *supra*; Central Furniture Mart v. Johnson, *supra*. Testimony alone is not enough. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill.App.3d 203, (1st Dist. 1991), A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833-34 (1st Dist. 1988), 86 Admin. Code ch. I, § 130.1405 (a).

The Retailers' Occupation Tax Act has a specific requirement for maintaining books and records, which provides as follows:

Every person engaged in the business of selling tangible personal property at retail in this State shall keep records and books of all sales of tangible personal property,

together with invoices, bills of lading, sales records, copies of bills of sale, inventories prepared as of December 31 of each year or otherwise annually as has been the custom in the specific trade and other pertinent papers and documents.
35 ILCS 120/7.

A taxpayer's duty to keep such books and records is mandatory. Copilevitz, *supra*, 156 Ill.2d at 157, 242 N.E.2d at 207. If a taxpayer does not have adequate books and records to support its monthly tax returns, the Department is justified in going outside the taxpayer's books and records to obtain information to correct the taxpayer's returns. Young v. Hulman, 39 Ill.2d 219, 234 N.E.2d 797 (1968). If the corrected return is challenged, the Department must show that the method it used to prepare the corrected return meets some minimum standard of reasonableness. Central Furniture Mart, Inc. v. Johnson, 157 Ill.App.3d 907, 908, 510 N.E.2d 937, 939 (1st Dist. 1987).

Here, the taxpayer did not prepare and keep cash register tapes, a sales journal, a cash disbursements journal or a general ledger. The taxpayer gave the auditor guest checks, utility bills and purchase invoices for 1996. She was also given cash payouts and bank statements for 1995 and 1996. No other records were made available to her. The taxpayer failed to keep adequate books and records and did not offer any consistent, probable evidence identified with her books and records to rebut the Department's *prima facie* case.

Absent adequate books and records, the Department's auditor calculated the average monthly percentage of underreported credit card sales as being 53.35% for 1996 by reconciling the information that she had received from the taxpayer regarding credit card sales to the credit card sales information reflected on the bank statements. Not

having a similar audit trail for cash sales, she applied the same underreporting percentage to cash sales. Not having records for any of the other months in the audit period, she applied the same percentages to those months to determine the underreported sales for those periods. The Department's method of preparing the corrected return in this case meets a minimum standard of reasonableness.

The Negligence Issue

The last issue to be decided is whether the underreporting of receipts was due to negligence. The statute imposes a penalty if a tax return is prepared negligently. The amount of the penalty is an amount equal to 20% of the deficiency resulting from negligent reporting. 35 ILCS 735/3-5. "Negligence includes any failure to make a reasonable attempt to comply with the provisions of any tax Act and includes careless, reckless, or intentional disregard of the law or regulations." 35 ILCS 735/3-5(b). No penalty is imposed if the failure to comply with the statute was due to reasonable cause. 35 ILCS 735/3-5(c).

The auditor assessed the negligence penalty because taxpayer underreported receipts by in excess of 50% and made no offer to pay the deficiency. Tr. pp. 52, 64.

Taxpayer's witness, JANE DOE, testified that she is the manager of the taxpayer and an officer. Tr. pp. 7, 8. She is 31 years old and has lived in the United States since she was six years old. Tr. p. 9. She completed two years of college taking some sort of management courses. *Id.*; Tr. p. 28. She handled all of the customer tickets. Tr. p. 20. She gave the information to the accounting firm to prepare sales tax returns. Tr. pp. 15, 16. The only records she kept were receipts and bank statements. Tr. p. 16. Taxpayer had a cash register with a tape recording mechanism but the neither Ms. DOE, nor

anyone else learned how to use it. Tr. pp. 17, 30, 31. Ms. DOE never talked to the accountants about the kinds of books and records taxpayer ought to keep. Tr. pp. 28, 29.

The testimony of Ms. DOE shows that she failed to make any reasonable attempt to comply with the law by keeping proper books and records. She never talked to the accountants about what kind of records the business should maintain. She never tried to learn how to use the recording mechanism in the cash register. During the evidentiary hearing, she offered no evidence to show reasonable cause. There is more than enough evidence in the record to establish the taxpayer's conduct as being careless and lacking any reasonable effort to comply with the law.

Therefore, I find that taxpayer has failed to overcome the Department's *prima facie* case and I recommend that the NTL be made final.

ENTER: September 7, 2000

Administrative Law Judge